

BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO

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|---------------------------------|---|------------------|
| In the Matter of the Protest of |) | |
| |) | DOCKET NO. 17419 |
| [REDACTED], |) | |
| |) | DECISION |
| Petitioners. |) | |
| _____ |) | |

[Redacted](petitioners) protest the Notice of Deficiency Determination issued by the auditor for the Idaho State Tax Commission (Commission) dated April 15, 2003. The notice of deficiency determination asserted additional Idaho income tax and interest in the total amount of \$38 for 1996 and denied refunds in the amounts of \$649 and \$573 plus applicable interest for 1997 and 1998, respectively. The loss claimed for 1999 was reduced; this did not result in either a deficiency or a refund.

During the years here in question, the petitioners owned stock of [Redacted] an S corporation. [Redacted] filed returns on a fiscal year ending November 30. For the fiscal year ended November 30, 1999, the petitioners owned 38.75 percent of the stock of [Redacted]. Prior to that year, they owned 50 percent of [Redacted]'s stock. Funds were advanced to [Redacted] by a partnership ('the partnership'), half of which was owned by the petitioners. It appears that the sum of these amounts was \$339,805 (\$324,845 in 1998 and \$14,960 in 1999). The petitioners contend that these advances from the partnership should be considered to have been loans from the partners to [Redacted].

Apparently there was a loan from [Redacted] to one [Redacted] which was repaid to [Redacted]. It is the petitioners' position that this repayment should be considered a loan from the petitioners to the corporation.

[Redacted] reported a substantial loss for 1999. Since [Redacted] is an S corporation, this loss was reported on the returns of the shareholders, including the petitioners. This produced a net operating loss for the petitioners. The net operating loss, as computed by the petitioners, was carried back to prior years. The petitioners filed claims carrying the loss back.

The questions to be answered all have to do with the amount of the loss from [Redacted], an S corporation, that should be allowed the petitioners for 1999. The petitioners had a net operating loss for 1999. Portions of the net operating loss, as computed by the petitioners, were carried back to 1996, 1997, and 1998. In the auditor's original analysis, the petitioners had a net operating loss for 1999 in the amount of \$3,907 which was carried back to 1996 and was fully absorbed in 1996. Therefore, no net operating loss deduction was available to be applied to the petitioners' 1997 or 1998 liability. Accordingly, the claimed refunds for 1997 and 1998 were denied.

After the issuance of the notice of deficiency determination, the representative for the petitioners submitted his computation of both the stock basis and the debt basis for the petitioners. The auditor accepted the representative's computation of the *stock* basis. Accordingly, the auditor modified the amounts that she felt were due. This increased the allowable loss from [Redacted] for 1999 and eliminated the deficiency for 1996 due to an increased net operating loss from 1999 being available to be carried back to 1996. In the auditor's final analysis, the petitioners had a net operating loss for 1999 in the amount of \$56,610, which was also carried back to 1996 and was fully absorbed in 1996.

It appears from the information in the file that the sole disputed issue is the extent, if any, that the petitioners are entitled to an increase in their allowable loss due to "the adjusted basis . . . of any indebtedness of the corporation to the shareholder." Internal Revenue Code § 1366(d)(1)(B). The representative for the petitioners contended that the petitioners were entitled to such an

increase. The auditor stated that the petitioners were not entitled to such an increase in their basis and cited several points of authority to support her position. The petitioners have not provided either documentation showing that the auditor's assessment of the facts was erroneous or authority showing that the authority cited by the auditor should not be considered to be pertinent and controlling.

The authority for the allowance and the limitation of the deduction of the losses from the S corporation is set forth in Internal Revenue Code § 1366(d)(1). It stated, in pertinent part:

Special rules for losses and deductions. (1) Cannot exceed shareholder's basis in stock and debt. The aggregate amount of losses and deductions taken into account by a shareholder under subsection (a) for any taxable year shall not exceed the sum of

(A) the adjusted basis of the shareholder's stock in the S corporation (determined with regard to paragraphs (1) and 2(A) of section 1367(a) for the taxable year), and

(B) the shareholder's adjusted basis of any indebtedness of the S corporation to 1367(b) for the taxable year.

There is no dispute in this matter as to the adjusted basis of the shareholder's stock in [Redacted]. The sole question relates to the adjusted basis of indebtedness of [Redacted] to the petitioners.

Courts have repeatedly ruled that there must be an economic outlay by the taxpayer. See e.g., Underwood v. Commissioner, 535 F.2d 309 (5th Cir. 1976), affg. 63 T.C. 468 (1975); Estate of Leavitt v. Commissioner, 90 T.C. 206 (1988), affd 875 F.2d 420 (4th Cir. 1989); Perry v. Commissioner, 54 T.C. 1293, 1296 (1970), aff'd, 1971 WL 2651 (8th Cir.). The courts have also ruled repeatedly that the debt in question must run directly from the S corporation to the taxpayer.

The Tax Court supplied the following analysis:

[A]n indebtedness to an entity with passthrough characteristics which advanced the funds and is closely related to the taxpayer does not satisfy the statutory requirements. Frankel v. Commissioner, 61 T.C. 343 (1973), affd. without published opinion 506 F.2d 1051 (3d

Cir.1974) (partnership); Prashker v. Commissioner, 59 T.C. 172 (1972) (estate); Robertson v. United States, 73 2 USTC par. 9645, 32 AFTR2d 73 5556 (D.Nev.1973) (trust); Burnstein v. Commissioner, T.C.Memo. 1984 74 (S corporation).

Hitchins v. Commissioner, 103 T. C. 711 (1994).

It appears that the facts regarding the loans from partnership to [Redacted] are, in substance, the same as in Frankel, *supra*, and Blalock v. United States, 695 F. Supp. 874 (N.D. Miss. 1988), both of which denied additional basis for the indirect loans made through a partnership. Accordingly, the Commission denies the petitioners the relief they seek with regard to the loans made through the partnership.

The other portion of the issue appears to involve the repayment of loans from [Redacted] to one [Redacted]. No viable explanation has been found in the file indicating why this should be pertinent. The burden of proof rests with the petitioners in this case. Idaho State Tax Commission v. Stang, 135 Idaho 800, 803 (2001). The Commission finds that the petitioners have failed to carry their burden of proof with regard to this item.

WHEREFORE, the Notice of Deficiency Determination dated April 15, 2003, is hereby MODIFIED, and as so modified, is APPROVED, AFFIRMED, and MADE FINAL.

DATED this _____ day of _____, 2006.

IDAHO STATE TAX COMMISSION

COMMISSIONER

CERTIFICATE OF SERVICE

I hereby certify that on this ____ day of _____, 2006, a copy of the within and foregoing DECISION was served by sending the same by United States mail, postage prepaid, in envelopes addressed to:

[REDACTED]
[REDACTED]

Receipt No
